U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT HOUSING INVESTMENT GUARANTY PROGRAM

OVERSIGHT HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL ECONOMIC POLICY AND TRADE

OF THE

COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 28, 1995

Printed for the use of the Committee on International Relations

U.S. GOVERNMENT PRINTING OFFICE
20–972 CC WASHINGTON : 1996

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052178-5

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OVERSIGHT HEARING ON THE U.S. AID HOUSING INVESTMENT GUARANTY PROGRAM

WEDNESDAY, JUNE 28, 1995

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m. in room 2200, Rayburn House Office Building, Honorable Toby Roth, chairman presiding.

Mr. ROTH. Good morning. Today this subcommittee is making the first public release and statement of an 18-month General Accounting Office investigation of the Foreign Aid Housing Guaranty Program.

In 1993 we launched this investigation on a bipartisan basis. We had received disturbing signals that this program was in trouble.

This report goes beyond our worst fears, and the results will disturb every Member of Congress and every U.S. taxpayer. Under this program, the U.S. Government—that is, the American taxpayer—guarantees loans for housing and urban development projects in countries around the world.

If the borrower fails to pay, the U.S. Agency for International Development, USAID, covers the loan and assumes the debt. USAID has issued $2.6 billion in guaranties in 44 countries. In 22 countries, half of those in the program, governments have allowed borrowers to walk away from these loans, leaving the American taxpayer holding the bag. More than half a billion dollars already has been paid out to cover these loans.

USAID is still holding over $400 million in these bad loans. What is worse, these losses on the existing guaranties will double to $1 billion according to the Government Accounting Office (GAO).

USAID's reserves are only $50 million. That means that the taxpayer is on the hook for these future losses. GAO also finds that the program does not meet its basic purpose, to increase the local financing available for low income housing.

A draft of this report was the basis for my amendment to shut down this program, and impose a tough penalty on foreign governments which abet these defaults.

The House passed this amendment as part of the foreign assistance authorization bill, which is now pending in the Senate. Now that GAO's report is final, we want to have a public airing of its conclusions, and allow USAID an opportunity to present its response.

Our questions are simple and direct:

What is wrong with this program?

How do we get the taxpayers' money back?

And how do we prevent this from happening again?

To answer these questions, and to allow me to discuss this with Speaker Gingrich and Senator Dole with some authority later today when I make my report, we have with us Frank Conahan, senior foreign policy advisor to the Comptroller General and David Hales, Deputy Assistant Administrator of USAID.

Before we proceed, let me ask the two gentlemen to come to the table, and to make their opening statements. And then let us ask a few questions, so we can make an accurate and objective report to the Congress later today. I think that we will start with Mr. Conahan, and then Mr. Hales.

STATEMENT OF FRANK C. CONAHAN, SENIOR DEFENSE AND INTERNATIONAL AFFAIRS ADVISER TO THE COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. CONAHAN. Thank you, Mr. Chairman. I appreciate the opportunity to be here. You mentioned in your opening statement that you have before you a copy of the report that we earlier rendered to you. We have a statement that we would like to submit for the record today, and then perhaps I can just summarize a few remarks.

Mr. ROTH. Let us proceed under that direction.

Mr. CONAHAN. I think that what I would like to do is to leave this subcommittee today with about five points. First, that this program has evolved over time. It has evolved from financing homes in Latin America to a wide assortment of shelter related activities around the globe.

Second, assistance has increasingly gone to advanced and creditworthy developing countries, which have ready access to other financing.

Mr. ROTH. What are some of those countries, if I can just interrupt you?

Mr. CONAHAN. Tunisia, India, Thailand are three.

Third, the program has not had the intended impact of stimulating local private sector investment in low income shelter.

Fourth, USAID does not always know whether the programs are benefiting the poor target population. And in many instances, we found in our review that it is not.

And finally, the point that you emphasized in your opening statement; many borrowers have defaulted on loan payments forcing USAID as guarantor to make payments for them.

We estimate that the total cost to the program, based on the current portfolio, will be about $1 billion, the number that you stated in your opening statement.

Mr. Chairman, what I would like to do for just a moment is to focus on the purpose and goal of the program. I think that this is necessary, because I suspect that Mr. Hales and I will have some dialog on this later on.

I would like to go directly to the law, if I can, to section 221 of the Foreign Assistance Act, which is the housing guaranty provision, and just quote very briefly:

> The Congress finds that carefully designed programs involving U.S. capital and expertise can increase the availability of domestic financing for improved shelter and related services for low income people by demonstrating to local entrepreneurs and institutions that providing low cost shelter can be financially viable.

One more statement:

> The Congress declares that the long-run goal of all such programs should be to develop the best of construction capabilities, and to stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low cost shelter programs and policies.

Now the reason that I wanted to do that is because in commenting on our report, USAID made an attempt to draw a conflict between that provision of law and the following provision of law, which talks about the activities that are to be carried out under the guaranty program.

I, quite frankly, cannot see any conflict or inconsistency there. And I think that it was an attempt on the part of USAID to mute the long range policy and statutory goals in favor of implementing the program the way that they have been doing it all of these many years. That is not a serious charge. I just see that as a rationale that crept in there for why they treated it as they did. And I thought that it was important to point it out.

First, let me talk about the evolution of the program. As I said, the program has gone from financing homes primarily to other activities. USAID has gotten into the area of policy reform. I think that this is an explicit recognition that demonstration projects themselves cannot do the trick in these countries. And I think, quite frankly, that was a good move on their part.

Also in the 1970's, they moved from financing U.S.-styled housing into a more basic minimum-standard housing. I think that was another good move. Since then, they have expanded into urban services, such as sewer and water treatment plants, electricity, and roads. And I think that this was a reasonable evolution in the program.

We have a few pictures over here, Mr. Chairman, and Mr. Manzullo. The first is a picture of a low-income housing program in Chile. This is typical of a number of the projects that USAID has been financing.

I would like you, Jim, to go to the second one right here. Now this happens to be a unit in that same area that has been improved by its owner. So you can see that they can do some pretty good things to this housing. So there are great benefits to this program. And I do not think that we can say that that is not the case.

Now, Jim, if you would go to the third one. Just to demonstrate the evolution a bit, this is a slum improvement project in Indonesia. You see that we financed the foot path and the drainage ditch right there.

OK. Let me now just say a few words about impact. And I think that this is important here. There is little evidence of progress toward the program's fundamental long term objectives. And that has to do with involving local private investors into this program. We just simply have not seen that in the course of our work. We talk about it in our report, and in our prepared statement. I do not need to say more about that at this point.

Now, as you know, Mr. Chairman, the Foreign Assistance Act requires that at least 90 percent of the guaranties be used to finance shelter suitable for families with incomes below a country's median income. But USAID, because of the way that it administers this program, is not always able to ensure that this is actually the case.

We found a number of instances throughout our review where the housing was not benefiting low income families. And indeed, USAID's own program records show, to a large extent in some instances, that low-income families are not benefiting, but rather upper-income families are benefiting.

For example, in a USAID study, we saw that about 36 percent of the program funds in India were benefiting upper-income families. And a study in Tunisia showed that 17 percent of a sampling of beneficiaries had above median income.

I have a few pictures here. This is a picture of a home in India. The participant here was an above-median-income person. This home was built with partial housing guaranty funding. There was other funding involved in it as well.

This next picture is another picture of a structure in India. This is essentially the same sort of thing. It is an above-median-income participant, partially financed with housing guaranty funds. This happens to be owned by an employee of the bank that is administering one of the housing guaranty programs. We found that one of the banks in India participating in this program was routinely making loans to its own employees for home improvements. And those employees were above the median income. So that is an indication on where we are going on that.

Now let us walk briefly through the program's financial condition. We both said earlier that the net cost after this program runs its course on its present portfolio is likely to cost on the order of a billion dollars. There are two reasons. No. 1, borrowers have already defaulted. And two, we estimate that they will default in the future.

If I may, Mr. Chairman, I would like to ask you to turn to page 39 of the report that you have in front of you. This is a pretty good job of showing where we stand on this program.

As you mentioned, something on the order of $2.7 or $2.8 billion in guaranties have been made over these years. And here is the cost that has already been incurred, and some projections of the future cost of this program. The chart in the upper right-hand corner of page 39.

I might point out that we have two columns here. We show costs in then-year dollars, the year in which these dollars were made available, as well as in 1995 dollars. The reason that we converted them to 1995 dollars is so to make everything, both past dollars and future dollars, the same. And it gives us a pretty good idea as to what we are talking about.

In the left-hand column, we show that there have been a number of appropriations. An appropriation was made in 1970 and one in 1985, for a total of $90 million. And then over a period of years, USAID has received loans which have not yet been repaid from the U.S. Treasury of $125 million. And then another series of appropriations of $168 million for a total of $383 million.

If you convert that to 1995 costs, that is $542 million. Those funds have already been spent. That has gone to cover defaults by borrowers.

USAID has received appropriations since the Credit Reform Act of 1990 of another $50 million for post-credit reform guaranties.

Now this next number, the $575 million, is what we estimate USAID will need to cover losses on its present portfolio. We believe that USAID will recover something on the order of $200 million after this is all said and done for a total net cost of $967 million, rounded off to a billion dollars.

Now USAID has disagreed with that billion-dollar estimate. It believes that it will recover most of the costs that it has already incurred, and any future costs that it may incur. I think that that is optimistic. To date, USAID has only recovered something on the order of 5 percent of all of the costs that it has incurred.

And one of the reasons that they have been able to make the claim that this is a low-cost program is because most of these loans get rescheduled. And a number of the loans have been rescheduled any number of times.

As a matter of fact, one of the countries has rescheduled its loans some ten times. So if we are willing to reschedule these things and carry the burden of them, we can make the claim that there is not much in the way of the costs. But given that experience and given the condition of these governments around the world that owe this money, I think that it is highly optimistic that USAID is going to get anywhere near what they are claiming to.

One additional point. There is a rather substantial technical assistance program that goes along with the housing guaranty program. We do not know what the total over the years has been in terms of money spent on that. But at the moment, there are projects with a cost of $471 million surrounding the housing program. We think that needs to be taken into account when discussing this whole issue.

In sum, Mr. Chairman, the way I see it, we have had a program structured in a manner that permitted a lot of money, billions of dollars, to be borrowed and spent by a variety of parties on a variety of activities, with the U.S. Government ultimately paying a big chunk of this cost.

Now the Credit Reform Act of 1990 had mitigated the U.S. Government liability to some extent. It is currently estimated somewhere around 15 percent in terms of setting up reserves. But we continue to have a program, whose beneficiaries are uncertain, and I have not seen that the data has done much to move along those lines, in countries who are not the most needy.

The Credit Reform Act, I think, has had its intended effect. And it has moved government lending into much more low-risk ventures. And we are seeing that happening here. But in terms of the Foreign Assistance Program, they are not necessarily the most needy countries.

I am prepared for your questions, Mr. Chairman.

[The prepared statement of Mr. Conahan appears in the appendix.]

Mr. ROTH. Well, Mr. Conahan, I appreciate your testimony here this morning. You certainly have laid it out easy enough for one to follow, especially when you deal with the numbers, on page 39. We appreciate your work.

Why don't we give Mr. David Hales, the Deputy Assistant Administrator of USAID, a chance to tell us about this program. Then we will go on to questions from myself and from other members. Mr. Hales.

STATEMENT OF DAVID HALES, DEPUTY ASSISTANT ADMINISTRATOR AND DIRECTOR, GLOBAL ENVIRONMENT CENTER, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. HALES. Thank you, Mr. Chairman, for the opportunity to appear before the committee. We very much welcome the chance to discuss a program that is fully supported by this administration, and one that we consider critical to our development efforts around the world.

In the GAO report, there are a number of concerns that are raised about the program. It is almost, Mr. Chairman, as though we have not a Tale of Two Cities here, but a Tale of Two City Programs here. Because we look at it, and we see very different things from what GAO has seen in its analysis.

In this time of declining public resources for development, as the challenges to us increase abroad, the credit programs offer the United States a cost-effective and efficient way to leverage resources and promote lasting development.

Most donors, Mr. Chairman, other nations and international financial institutions, and multilateral donors, rely heavily on credit programs as compared to grant assistance. We are one of the few donors that relies primarily on grant assistance in our development investment programs.

By and large, credit programs are found to be less expensive than grants. They have sustainable development and strategic advantages over grants in many instances and are still able to produce significant impact.

The housing guaranty program was closely reviewed by the Clinton administration at the beginning of this administration. I came on to the staff at USAID in October of last year and have had the opportunity to review it closely as well. There was no allegiance to this program, as we began those reviews, Mr. Chairman. And we have come to the conclusion that this program does indeed come through with high marks.

If I might quote from Mr. Conahan's most recent comments: that there are great benefits to this program, and GAO, in spite of this report, cannot say that this is not the case.

We are troubled that in this report that GAO has failed to make a distinction between the Housing Guaranty Programs in pre- and post-credit reform periods. The agency strongly supported credit reform and we feel that because of its improvements, the Housing Guaranty Programs are better than ever.

The pre-credit reform program was marked by both significant successes in a programmatic sense and some serious shortcomings. There were legitimate concerns about taxpayer liability from a system where reserves were not consistently put aside to pay potential losses. There is cost to that program. There is no question about that.

That is not the case with the post-credit reform portfolio. Structurally, the program bears little resemblance to its predecessor. The true cost of the program, by statute, must now be reflected in the appropriations process. Ample reserves are put aside for this and all other U.S. Government credit programs, by exactly the same process, based on the independent judgment of an interagency panel of experts.

The Congressional Budget Office reviews these estimates on an annual basis and each year to date has found them to be reasonable. The GAO report questions whether reserve funding is sufficient to meet potential liabilities of the program. It is a very fair question, and one that we are concerned about as well.

The difference between what the interagency panel of experts estimates as necessary to cover the liabilities of the program and the GAO assumptions is 4 cents on the dollar. The difference, Mr. Chairman, is between a 15 cent on the dollar reserve and a 19 cent on the dollar reserve.

In light of the fact that this program is so critical to our objectives, we believe that that is a difference which can be addressed short of termination of the program.

As context for this discussion, Mr. Chairman, please consider the following facts about the program.

The most serious allegation is that the program is in financial trouble, and we take that allegation exceptionally seriously. We do not believe that the program is in financial trouble.

GAO makes, in its findings, the assumption that of 17 countries that have rescheduled loans, a significant number will default on those loans permanently, with zero repayment. Yet since 1964, not one nation has permanently defaulted on its loan guarantee through this program.

The Government Performance Act and the Chief Financial Officers Act require that this program be subjected annual to independent audits financially and in terms of performance, and those audits, to date, have indicated a productive and well-managed program.

The Housing Guaranty Program over its history has taken in three-and-one-half times more in fees than it has ever written off as unrecoverable, a total of $142 million to a write-off of $39 million.

In this area of reduced budgets, Mr. Chairman, credit programs are an excellent way to expand and leverage our resources. Each dollar of budget authority for this program leverages about $7 in development assistance from other sources.

The reserve that exists today in the post-credit reform program is funded at about 15 cents on the dollar. The history of this program, Mr. Chairman, is that we have had to write off as unrecoverable only one-and-one-half cents on each dollar expended in this program.

The portfolio has experienced no defaults or write-offs since credit reform was implemented in 1992. USAID has collected 95.6 percent of the principal, interest, and fees due from rescheduled borrowers over recent years. Using $400 million worth of appropriations, this program has created $2.8 billion worth of programmatic investment in sustainable development in 44 countries.

Mr. Chairman, as we look at this program, it seems that we see two very different things. GAO looks at these programs and sees an unfunded liability to the taxpayers, and a program that does not meet its programmatic goals.

We agree that there is an unfunded liability to taxpayers associated with the pre-credit reform program. There is no action that USAID or this Congress can take to remove that liability. That is a liability that has already been incurred. None of us can estimate the sum total of what that liability is going to be, although we can look at its outside limits and make some assumptions about that. This is not true of the post-credit reform program.

Experts may differ on what percentage of reserve needs to be set aside. I am not an expert in this area, Mr. Chairman, and I cannot tell you whether 15 cents on the dollar, or 17 cents on the dollar, or 13 cents on the dollar, or 19 cents on the dollar is the appropriate reserve. But it seems to me that experts ought to be able to come to agreement on that issue and bridge that gap.

USAID looks at these programs, and instead of GAO's view, we see tools for promoting U.S. interests abroad and addressing critical constraints for sustainable development. We see a program that has returned in interest payments $3.9 billion to U.S. investors over the life of this program. We see a program in which most countries repay their obligations, and, most important, in which the real beneficiaries, lower income families—not the American taxpayer, pay for what they receive.

Under the worst case scenario, Mr. Chairman, this is a program that costs the American taxpayer only $1 for every $5 in program benefits.

Moreover, Mr. Chairman, and perhaps most important, we see this as a program that has demonstrated in real and practical ways to millions of families that the future can be different from the past, and that they can have hope and aspiration for the future. And that the price of admission to that future is not a grant, not a handout, not a give-away, but the individual acceptance of responsibility on their part, and their own hard work as they pay their own costs.

We see a program that can be improved. There is no question about that. During the time that GAO was preparing its report, we initiated a number of changes, which are not reflected in that report. The program has a new administrative home, one in which it is an integrated part of a strategy to address constraints to development as it has never been integrated before.

The agency has new financial management and accounting systems that gives us much more effective control than those that existed only a year ago.

The program functions in a results management framework that did not exist a year ago and which allows much greater "deeds-to-dollars" accountability in the future than we have ever had in the past, as well as increased transparency and accountability.

We are restructuring the management procedures within the agency to ensure transparency and accountability of the program, and we are changing the nature of the regional housing and development offices to make them more integrated into the broad attack on constraints on sustainable development.

There is likely more than we can do and should do. We need your help, Mr. Chairman. We need the help of Congress. We need the help of reviewers like GAO and others, as we try to improve this program.

But we believe very strongly, Mr. Chairman, that the creditability, the credit programs of USAID, like this program, are critical to our ability to respond to needs. They will not work in all countries. That is true. They will not work in every instance in the countries where they do work. That also is true. There is improvement that can be made, but it is an important tool.

And we would ask, Mr. Chairman, that we work together to try to find ways to make credit authority an effective tool for effecting U.S. interests abroad. Thank you.

[The prepared statement of Mr. Hales appears in the appendix.]

Mr. ROTH. Well, thank you, Mr. Hales for your testimony. I see that you are a good advocate for your position.

Let me say before we start the questioning that I believe, Mr. Hales, you, and Mr. Conahan, myself, and Mr. Johnston are all working for the same government, right?

Mr. HALES. Yes, sir.

Mr. ROTH. So we do not have to worry about an adversarial relationship. What I want to do is to get to the bottom of what is happening with this program. For all too long, ever since I have been in Congress long before we were in the majority, there is no oversight, no accountability here. And that is why I want to go to Speaker Gingrich and Senator Dole to make a report today and say, "This is what I found." I want to make sure that there is a good, objective report.

I am going to ask Mr. Johnston for his questions first. But before I do, Mr. Hales, you said that the administration fully supports this program?

Mr. HALES. Yes, sir.

Mr. ROTH. Well, that cannot be. Let me give you a chance to explain. We currently have a big mark-up going on over in the Banking Committee. We were in until 12 last night, making sure that the American taxpayer was protected, from all of the problems that go on in our banking system. (Pointing to GAO exhibit)

Is this home right here financed through this program?

Mr. HALES. I am not sure about the source of that picture, but I can address the India program in some specifics, if you would like, Mr. Chairman.

Mr. ROTH. Well, I will not let you do that.

An employee at that bank has that house financed through this program?

Mr. HALES. Well, let me give some context to this. Despite what GAO claims, in India the Housing Guaranty Program has an investment of about $150 million. It has leveraged a much larger investment from Household Finance Corp. throughout India. I believe that there are some 22 separate entities in India that are participating in the overall program.

$294 million has been loaned through that joint program to date. Our sample surveys indicate that 78 percent of that, or $229 million, has gone to households with incomes below median incomes. Now we only have $150 million in this program, Mr. Chairman, and $229 million of the combined program of those resources has gone to individuals who have below median incomes.

These Housing Finance Corp. have traditionally lent to over median income households. The HIG program guaranties, our $150 million compared to the $229 million, which these companies are investing in their own funds, is helping to drive their market down to below market or to the appropriate target for this program, below median income individuals. It seems to me that, that is a substantially good investment on the part of the American taxpayer.

Mr. ROTH. It does not focus on my question though. Because in the Banking Committee, we have had a big row about how we are not giving our own people an adequate chance for housing.

Is it possible that we are financing this home for an employee of the bank?

Mr. HALES. I think that the best answer that I can give you, Mr. Chairman, is the one that I have given you. We have $150 million in that program and $229 million has gone to below median income folks. This home may well have been financed from the overall program, which does have USAID funds in it. But we are getting a very good return for the U.S. taxpayer.

Mr. ROTH. You are going to have to go to the Banking Committee with me. As I said before, we are working for the same government. And we want to get to the bottom of what is happening in is program.

I have a number of questions here, but I think I will ask Mr. Johnston first, because we appreciate him attending the hearing this morning.

Mr. JOHNSTON. Thank you, Mr. Chairman.

First, if I could introduce a statement by the ranking member, Mr. Gejdenson, without objection.

Mr. ROTH. Without objection.

Mr. JOHNSTON. Thank you.

[The prepared statement of Mr. Gejdenson appears in the appendix.]

Mr. JOHNSTON. Reading your statement, it pretty much parallels.

Mr. ROTH. What he said?

Mr. JOHNSTON. Yes, yes. I thought maybe he wrote yours, or you wrote his. I am not sure.

Mr. ROTH. Well, he helped me with mine.

Mr. JOHNSTON. If I could get a perspective currently of the program, Mr. Chairman. You are much more knowledgeable than I. Literally, we are kind of pallbearers here for the program.

Was not the program zeroed out in the authorization bill?

Mr. ROTH. Yes.

Mr. JOHNSTON. And at what point does it self-destruct, in what fiscal year, do you have a glide path just for my information?

Mr. ROTH. Well, we do not have any new guarantees after the fall of this year.

Mr. JOHNSTON. OK. So there is nothing appropriated in the bill that is on the floor today that follows the authorization?

Mr. ROTH. That is right. There is nothing in the bill on the floor today. But I think that this is a good metaphor for other AID programs and what is happening with them.

Mr. JOHNSTON. Mr. Hales, in the Chairman's opening statement, he said that more than a half a billion dollars has already been paid out to cover these loans.

Is that a correct figure in your estimation?

Mr. HALES. We have written off, Congressman, some $39 million. Now that does not mean that those loans have been forgiven in any way. That simply means that we do not expect to be able to get those loans repaid. We have also rescheduled debt, which has put us in a position of paying money to investors in the United States to cover that rescheduling of debt.

We fully expect to be able to receive payments and meet that debt, and pay off those accounts. There is a liability there. I cannot tell you exactly what that liability is. But the history of the program is that our total pay-out in terms of write-offs is only one and one half percent. Likely, we will end up with a greater liability than that. I think that it is very clear that the pre-credit reform program did create those liabilities. But canceling the program at this point can have no effect at all on those particular liabilities.

Mr. JOHNSTON. In 19 countries, you have rescheduled their payment.

Since 1992, have any of these countries defaulted on the reschedule payment schedule?

Mr. HALES. If I could make one amendment to the way that you asked the question. Congressman, we do not reschedule debt. That is not a choice that the U.S. Agency for International Development can make. We are caught in a process for rescheduling debt that applies to all of the credit programs of the United States, of which we represent about 2 to 3 percent of the total Federal liability for all credit programs in the process of rescheduling debt.

No loan, to my knowledge, has ever been rescheduled because of a particular problem with the Housing Guaranty Loan Program repayment. Rescheduling occurs as a result of macroeconomic issues that are far broader than this tiny percentage of this program in various countries. I cannot tell you what the number of countries are, although I would be glad to submit for the record an analysis of each of those 19 in terms of when they have rescheduled and how often they have rescheduled those. I have not committed that to memory.

Mr. JOHNSTON. If you could.

Mr. HALES. I would be happy to.

[The information referred to appears in the appendix on page 55.]

Mr. JOHNSTON. Mr. Conahan, one of the principal complaints about this Housing Guaranty Program is that private credit institutions really have not gotten involved here. Now I have been informed that in Indonesia alone that they have over a half a billion, $590 million to be specific, in private sector investment. And in India, they have about a billion dollars of private segment investment.

Is that correct in your investigation?

Mr. CONAHAN. I cannot confirm those precise numbers. But the fact of the matter is that in those countries that you will find a fair amount of private sector investment in the housing sector. Our point is that with respect to the USAID Housing Investment Guaranty Program, that you find very little in the way of private sector investment there. What you find for the most part are government programs. You find commercial banks associated with these programs, but they are generally handling government funding. There is very little in the way of private sector funding involved in specific Housing Investment Guaranty projects.

Mr. JOHNSTON. What is your observation, Mr. Hales, to that answer?

Mr. HALES. In most of those countries, Congressman, that private sector investment did not exist before the USAID program came in, showed that it was possible to make money in this sector of the market, and created the skills necessary for those industries and those jobs to exist within those countries.

I think that if you look at the experience around the world, that it is perhaps most apparent in Latin America. There was no savings and loan industry prior to the Housing Guaranty Program. There is a thriving savings and loan industry now. That industry certainly does benefit more than just those below median income. Our resources continue to be focused in that way, but we take great pride in the fact that we have created a framework and taught lessons through pilot projects which have led others to emulate that behavior and create an active private sector market in these countries.

Mr. CONAHAN. Mr. Johnston, I need to state that our findings do not totally confirm what Mr. Hales has presented to you. In the several countries that we went to, most of the commercial bankers that we talked to said that they simply were not going to put their own funding in these kinds of projects.

Yes, indeed, they will get into the broader housing sector. But in these particular endeavors, they were not about to put their own money into it.

I think that it is commendable what USAID has done overall in terms of this program. And it is not only the Housing Guaranty Program, but it is the large sums of money that they have put into technical assistance. USAID has technical assistance projects to help governments in policy reform.

They have technical assistance projects to help commercial banks and savings institutions in those countries. They have technical assistance programs to assist housing authorities, all in an effort to develop this area.

Mr. JOHNSTON. Let me move along, Mr. Conahan, because I will run out of time.

Mr. CONAHAN. But we do need to differentiate, I guess, between the product.

Mr. JOHNSTON. Two different programs.

So they are not all bad is what you are saying?

Mr. CONAHAN. No, not at all.

Mr. JOHNSTON. In your report here, you are concerned about the solvency of this program, Mr. Conahan.

And revolving around your concern that these countries to whom the aid has been given would default, to meet the worst case scenario that you are concerned with, how many countries would have to default simultaneously for this program to belly up? And if you could list the number of countries that have permanently defaulted on their loans, I would appreciate it.

Mr. CONAHAN. The way that this program is administered does not result in countries for the most part permanently defaulting on their loans. There have been a few in that category, but only in a minor amount.

Mr. JOHNSTON. Do you know which countries have permanently defaulted?

Mr. CONAHAN. I think that Botswana is one that has gone.

Mr. JOHNSTON. Botswana has got $100 million in the bank.

Mr. CONAHAN. This is an old loan.

Mr. JOHNSTON. It is the only solvent country in Africa.

Mr. CONAHAN. I would have to provide the others for the record.

Mr. JOHNSTON. You are sure it is Botswana?

Mr. CONAHAN. Is that correct?

Mr. JOHNSTON. I have got a lot of noes in that front row back there.

Mr. CONAHAN. Iran.

Mr. JOHNSTON. Iran?

Mr. CONAHAN. Yes.

Mr. JOHNSTON. A little distance from Botswana.

Mr. CONAHAN. You are right.

Mr. JOHNSTON. OK.

Mr. ROTH. Would the gentleman yield for a moment?

Mr. JOHNSTON. Sure.

Mr. ROTH. I think that in all fairness to the gentleman here that you had mentioned to Mr. Johnston that some countries have been rescheduled ten times?

Mr. CONAHAN. That is correct. I stand corrected on Botswana.

Mr. ROTH. In the real estate business, if you keep on rescheduling, what difference does it make? You can reschedule ad infinitum. You will never come to a time.

Mr. CONAHAN. I think that the point here is that these countries have defaulted when payments have become due. USAID has made payments on their behalf, and then rescheduled the loan. And that is where we stand at the moment.

Mr. JOHNSTON. Literally paying their interest, OK. The last question, Mr. Hales. Mr. Roth and I are both on the Africa Subcommittee, and have been following very closely the South African initiative that your organization was very instrumental in.

Will the dissolving of this program affect your housing initiatives in South Africa?

Mr. HALES. "Yes, sir if the proposed House Bill is enacted, we would not be able to issue new guaranties in South Africa, and would have to abrogate unilaterally agreements that have already been signed. I think that it would have a very unfortunate impact.

Mr. JOHNSTON. I have just been informed that South Africa was excluded.

Mr. ROTH. Yes, South Africa was excluded. That is incorrect, Mr. Hales.

Mr. JOHNSTON. Thank you, Mr. Chairman.

Mr. ROTH. Well, thank you, Mr. Johnston.

Mr. Conahan, let me ask you some questions, so I can bring this issue more into focus. I was taking some notes here, as both you and Mr. Hales were speaking.

USAID has $2.7 billion in guaranties outstanding in 44 countries, is that right?

Mr. ROTH. Is that right?

Mr. CONAHAN. Yes, sir.

Mr. ROTH. In your report to the Congress on Housing Guaranty Programs on page 56 you list here some 22 countries where USAID has had to pay claims.

That means that USAID has assumed the loans, is that correct?

Mr. CONAHAN. Assumed that portion of the loan. They have made payment to the lender.

Mr. ROTH. That is in 22 countries?

Mr. CONAHAN. Twenty-two or twenty-three.

Mr. ROTH. Thus far, USAID has paid out over half a billion in claims as measured in 1995 dollars, is that right?

Mr. CONAHAN. That is correct; yes, sir.

Mr. ROTH. It is over a half a billion.

And to pay these claims, USAID has used taxpayer funds as well as borrowings from the U.S. Treasury, is that right?

Mr. CONAHAN. Yes. $125 million was borrowed from the Treasury, and the remainder were appropriations.

Mr. ROTH. $125 million?

Mr. CONAHAN. Yes, sir.

Mr. ROTH. On page 56 of your report, you show that for these bad loans that USAID was owed some $409 million as of September 30th?

Mr. CONAHAN. Of 1994; yes, sir.

Mr. ROTH. You estimate that of these existing guaranties another $600 million in claims will be paid?

Mr. CONAHAN. That is correct. And I would like to differentiate, since this has been brought up. Something on the order of $575 million, according to our methodology, would be on pre-credit reform guaranties, and $50 million on post-credit reform guaranties, for a total of $625 million, which we rounded off in the report to $600 million.

Mr. ROTH. So, basically, the bottom line from your findings is that 1 billion in claims will be paid by these existing guaranties over the lifetime?

Mr. CONAHAN. That is correct.

Mr. ROTH. One billion.

In USAID's file, did you find any outside audit that corroborates your estimate?

Mr. CONAHAN. The 1993 audit of the Housing Guaranty Program by the USAID Inspector General includes the financial statements for the program. And the financial statement through 1993, we have not seen the 1994 statement yet, but for 1993 the balance sheet contains a liability for loan guaranties pre-1992 of $706,889,000, and liabilities for the loan guaranties post-1991 of $2,957,000. So their number for pre-credit reform is $706,000,000 as of September 1993.

Mr. ROTH. Now your estimate is that USAID will recover about $200 million, as I recollect you had mentioned?

Mr. CONAHAN. Right.

Mr. ROTH. How did you come to that $200 million figure?

Mr. CONAHAN. Well, let me go back to how we came to our $575 million, because it is the same methodology. We have developed a methodology to determine potential default on international lending. It essentially takes ratings by *Euro Money*, and the *Institutional Investor*, and information provided to us by commercial banks who deal in the secondary markets. We use some economic analysis, and came up with ratings that we thought were reasonable. We then applied them to the portfolio, and came up with the estimate of $575 million.

What we did was we took that same methodology, and applied it to the amount that is owed to USAID, and came up with the $200 million number.

Mr. ROTH. On the $200 million, of course, there is a big disparity here.

Now the rest of the money, I am assuming will come from the American taxpayer, is that right?

Mr. CONAHAN. That is the only place that it can come from.

Mr. ROTH. I have been looking out at these trees, and I do not see any money growing on them.

Mr. CONAHAN. I think that USAID will continue to need appropriations to the extent that these defaults continue.

Mr. ROTH. So the American taxpayer will be the pallbearer, to use Mr. Johnston's words?

Mr. CONAHAN. Appropriations will be required.

Mr. ROTH. How much does USAID have on hand to cover the claims?

Mr. CONAHAN. Well——

Mr. ROTH. Somewhere in here, it says $50 million, I believe.

Mr. CONAHAN. Well, they have got $50 million for the new program, for the post-credit reform, but very little for the pre- credit reform.

Mr. ROTH. These are 100-percent guaranties, principal and interest?

Mr. CONAHAN. Yes, sir.

Mr. ROTH. So the lender really has no risk?

Mr. CONAHAN. No, sir.

Mr. ROTH. So the guy that you were talking about in Indonesia or India who says he will make these loans, he makes the good loans and then takes USAID money and makes the other loans?

Mr. CONAHAN. Well, the U.S. commercial banker, or the saving institution, or the insurance company in the first instance is making the loan. But inasmuch as USAID is guaranteeing that, he is not taking all that much risk.

Now on the local level, it is sort of a mixed bag. And I cannot really talk in specific terms about how that risk is shared.

Mr. ROTH. But the American taxpayer is really taking all of the risk, is he not?

Mr. CONAHAN. Correct; yes, sir.

Mr. ROTH. That seems to be a basic flaw.

Who is looking out for the taxpayer?

Mr. CONAHAN. Well, that is the design of the program, I must say. I am not sure that the designers expected that it would turn out this way, but it has. There is not much in the way of legislative history as to what sort of loss might have been anticipated at the time. I think that if you take a look in terms of what the broader objectives were, that not much in the way of loss was anticipated.

They expected that these loans would be solid loans. They expected that eventually they would lead to private sector investment in these countries. And that would have been a different situation from what we have now.

Mr. ROTH. Now you are a pretty diplomatic person. I think both of you are, Mr. Hales, and Mr. Conahan.

But basically, what I interpret you saying is that Congress, years ago when these programs came on, should have had more insight. Is that what you are saying?

Mr. CONAHAN. I am saying——

Mr. ROTH. I want you to speak straightforwardly. Because I am interested in the truth, wherever the chips may fall.

Mr. CONAHAN. USAID used a methodology to come up with its $700 million. We used a different methodology. But they are really not very far off. OMB has a methodology. And they all get you to about the same place. I think that the fact of the matter is that OMB, AID, and ourselves all expect some sizable loss eventually on these loans.

Mr. ROTH. Well, let me ask you this.

Mr. HALES. Mr. Chairman, if I could, no less diplomatically, but perhaps somewhat more directly respond to your question, if you would not mind.

Mr. ROTH. All right.

Mr. HALES. I think that it goes to the heart of the difference between the pre-credit reform program and the post- credit reform program. And that is something that I think is lost sight of in the GAO report. And it is something that we need to be very careful not to lose sight of as we make future policy.

We set aside funds now in appropriations on a pay-as-you-go basis to reflect the true cost of this program. We can debate the magnitude of that set-aside, whether it should be 15 cents on the dollar or 19 cents on the dollar, but that is an appropriate debate. The liability that exists before that cannot be corrected in any way by terminating the program at this date. That liability, whatever it may be, already exists. And the taxpayers are in fact on the hook for whatever that liability is, and it will take some cost to pay for that.

Under the worst case scenario, we will still have gotten five dollars of investment overseas for $1 of expense to the U.S. taxpayer. And I understand your concern, and we share it. And that is why we prefer the post-credit reform program.

Mr. ROTH. Let us analyze that. Let me ask you this. I was interested in Mr. Johnston's questioning.

Has USAID issued any new guaranties to governments which have already made bad loans?

Mr. HALES. Well——

Mr. ROTH. It is very interesting to me. I could get billions of dollars of loans if you keep on rescheduling, and I will never be found in default.

Mr. HALES. The program does continue in countries that have rescheduled debt.

Mr. ROTH. It does?

Mr. HALES. It does. Only in countries where we had legally binding agreements prior to credit reform. And in the Credit Reform Act, there is an explicit provision recognizing the sanctity of those relationships. Yes, indeed, we continue to make loans to rescheduled countries. That was recognized in the Credit Reform Act, very explicitly in that Act.

Mr. ROTH. Is that not throwing good money after bad though?

Mr. HALES. I am sorry?

Mr. ROTH. Is that not throwing good money after bad? That does not seem to be a wise course of action.

Mr. HALES. Mr. Chairman, this program has only written off loans that are non-sovereign loans to the tune of $39 million. We have never written off a loan to a country. We have rescheduled.

Mr. ROTH. Mr. Hales, you rescheduled some of these debts twelve times.

Mr. HALES. We have rescheduled, Mr. Chairman. But in the process of rescheduling, we are still collecting interest, just as if you rescheduled your home mortgage. And we are at 95.6 or 96.5, right at 96 percent, of collecting all of the fees, interest, and principal, which is due on those rescheduled loans. And investors in this country, Mr. Chairman, as a result of all of those payments have made $3.9 billion on a $2.8 billion program. It is good business at home, and it is good business abroad.

Mr. ROTH. It certainly would not be good business at home. That is why we have a big issue before Banking. Your local bank would not reschedule your mortgage ten times in a row. That is not being fair. Again I do not mean to be confrontational. But by God, somebody has got to speak up. That is not fair to the taxpayer. We should not be doing that.

I am going to get to you. I just want to ask a few more questions. This program is supposed to operate under a legal ceiling of total value of guaranties.

Can you enlighten us a little bit on that, Mr. Conahan?

Mr. CONAHAN. Congress has put a ceiling on the total over the years. USAID, because it is able to reduce the amount outstanding as loans are repaid, is able to, however, and has gone over that ceiling from time to time. On paper, it has not gone over the ceiling, but in point of fact it has gone over the ceiling.

Mr. ROTH. I am going to ask Mr. Hales a few questions, too. Because I want to be fair to him, too. But, you know, I was just struck by something here.

When you looked at the accounting system of USAID, did you find that they, in effect, ever account bad loans as paid off, so they could justify new guaranties?

Mr. CONAHAN. I do not have information to that extent. And they have written off only $39 million. We would have to look into that.

Mr. ROTH. Maybe the fellows who are with you maybe could answer that question. That would be interesting.

Mr. MICHELS. They account as having been repaid under the ceiling, whether the borrower repaid them or USAID paid them on behalf of the borrower. So the amount under the ceiling would be reduced every time that is paid, even though that money gets rescheduled and may ultimately never be repaid by the borrower.

Mr. ROTH. I was afraid of that. I was afraid that that is the way that it operates. You know, in the past, the Congress has not focused on any of these issues. I was going through this book. I think it was on page 34 in your report. You have a note that many of the financial records are missing from USAID for guaranties prior to 1989.

Can you help us out with that a little bit, is there anything there that Congress should be concerned about?

Mr. CONAHAN. Well, there is not much that can be done about that. We asked for financial records. And they were able to produce financial records beginning, I think, in partial in 1987, and then a little better in 1988.

It was not until USAID was required by the CFO Act of 1990 to prepare financial statements and to have those statements audited that we saw the sort of accounting that we would expect to see.

Let me just say that at this point that we do not believe that USAID's accounting system overall is where it needs to be, but that is another matter. But they are improving substantially since that earlier period of time.

Mr. ROTH. You know, Mr. Hales, that does not speak very well for USAID's financial management and record keeping, does it?

Mr. HALES. I find that, as a new administrator in the agency looking at old programs can be very frustrating. But I think that it also highlights one of the things of which we are most proud. And that is the management reforms that have been instituted under Brian Atwood.

I think if GAO were to look at the financial management system that will go in place on October 1 of this year, that you will find that it is not only infinitely better than past systems, but also that it will provide the kind of detail that I frankly wish we had over the entire 30 year history of this program. Not having that detail is a frustration to us, too, Mr. Chairman.

Mr. ROTH. Mr. Conahan, give me a little background.

How many countries did you visit, and how many continents? I am assuming that you walked across the real estate in many of these areas.

Mr. CONAHAN. Yes, sir. We visited countries in South Asia, in the Far East, and in South America, I think for a total of seven countries. Yes, seven countries. And we looked at a variety of programs. We talked with program administrators, USAID people. We talked with participants in the program. We talked with commercial banks and other institutions that were involved in the program, housing authorities, and governments.

And it was on the basis of that rather extensive and comprehensive review that we came to the conclusions that I mentioned earlier.

Mr. ROTH. Your staff is familiar, I am sure, with what is going on here on the Hill, and also with amendment that I offered in the foreign assistance bill. Do you believe that this amendment will increase collections of bad loans?

Mr. CONAHAN. I think that the feature of it that cuts off aid for a failure to continue paying on these loans should very well do that. I think that one would have to point to that as a very positive feature of the bill. That was not a recommendation in our report. But I must say that we would have to characterize it as positive.

Mr. ROTH. Mr. Hales, you disagree with GAO's findings that you will not collect on these bad loans, but the U.S. Government has $400 million in bad loans as of last September, and what is the figure today?

Mr. HALES. I am not sure what the exact figure is. I will be glad to submit it. But those are rescheduled loans, Mr. Chairman. And I think that there is a distinct difference between a rescheduled loan and a bad loan, which in plain English—and I am not an accountant or a financial expert is one I am not planning to collect. It is something that I consider an outstanding liability. These loans are rescheduled, and I think that we will collect them.

[The information follows:]

CURRENT AMOUNT OF HOUSING GUARANTY "BAD LOANS"

The unaudited figure (as of 6/28/95) for claims, which is almost entirely made up of Paris Club reschedulings, amounts to $420.0 million.

Mr. ROTH. Mr. Hales, you and I are working for the same government.

Did you work in a bank before, I do not know your background.

Mr. HALES. No, sir. I am a park ranger, who has gotten promoted to my level of incompetence at least on this issue, I am afraid, in terms of technical expertise.

Mr. ROTH. Well, a park ranger. You seem like a smart fellow to me. If I were working at a bank and I had to reschedule a loan, I think that I would start questioning that loan.

Mr. HALES. The rescheduling issue though, Mr. Chairman, is not one that is under USAID's control in any form or fashion. This is not a choice that we make. I suspect that if we had the authority to reschedule or not reschedule, that we would make a series of decisions very differently than the Paris Club does.

We are a 2-percent tail on a 98 percent dog, just counting the resources in this country, plus an international financial system. We are working in that for a very specific purpose. And that has to do with development, not just making money.

Mr. ROTH. Mr. Hales, I understand. That argument works with a lot of people, but it does not work with me. Everything is only 1 percent of the government, or one half of 1 percent. It is a big, big government. And even one half of 1 percent is a lot.

Mr. HALES. I am just responding.

Mr. ROTH. The general public says "oh, that sounds great," but they do not stop to analyze what that means.

Mr. HALES. I am just responding, Mr. Chairman, that there are some things which we can control and others which we cannot.

Mr. ROTH. All right.

Mr. HALES. And it is not a decision that we have any influence on.

Mr. ROTH. OK. According to these findings here GAO estimates that you will pay another $600 million in future claims and existing guaranties. And that you will ultimately collect only about $200 million. We talked about that before with Mr. Conahan.

Now do you dispute that?

Mr. HALES. Yes, sir. That seems to be an estimate of which we cannot fathom the underlying assumptions. As we look at this, it seems to us that in order to get to that figure, you have to assume that all or some substantial portion of 17 or 19 countries are going to default on their loans and default permanently. That simply has not happened in the past.

We have no sense that in fact that is going to occur in the future. And the numbers are driven by the use of 1995 dollars, which at best seems an unusual practice to equate to 1995 dollars. That would not be standard U.S. banking practices, as I am informed by our financial officer.

When a financial institution originates a loan, it expects that at the end of that loan period, that the principal and interest will be repaid. Principal and interest are determined at the time of the loan. They do not change over the time of the loan. By translating the amount in the 1995 dollars, you artificially inflate and expect a return. And you can also inflate potential liabilities.

And I do not know if that is standard financial practice, Mr. Chairman. I would defer to those who are in that business. But it seems strange to our financial analysts.

Mr. ROTH. Well, that is the way that I look at a loan, too. The principal and interest are paid at the end of the period. But obviously, that has not taken place here. Because we are rescheduling many of these as many as ten times.

Mr. Conahan, you are dying to say something. Go ahead.

Mr. CONAHAN. I would like to comment on that. The methodology that we employed to do this is one that is very similar to the one that the Office of Management and Budget uses for setting up the reserves under the new Credit Reform Act. The 15 percent that USAID is now using comes out of a methodology which is very similar to the one that we use.

Now the reason that USAID is coming up with whatever it is, the 15 percent, is because the countries that it is making loans to today are considerably less risky than the ones that they linked to in the past. I think that if you use the OMB methodology, that it would come up with a number very, very similar to our number. So there should not be a disparity between GAO and the executive branch on this issue.

As a matter of fact, OMB in commenting on our methodology said that it wanted to get much closer to the market than it has been in the past. It did use the secondary market to some extent in its methodology, but it wanted to do more. As a matter of fact, the person most responsible in our organization for coming up with our methodology is now working with OMB in an effort to develop OMB's methodology more in line with ours, and OMB is willing to do that.

So I think that in the future that USAID, as well as other executive agencies, will be using a methodology which is very similar to the one which we use, which resulted in these numbers.

Mr. ROTH. That is a case, Mr. Conahan. And I see Mr. Hales agreeing.

What is the sense of the American taxpayer financing housing in middle income countries?

Mr. CONAHAN. That was a point that we said we thought was somewhat at odds with the initial thrust of this program.

Mr. ROTH. Especially when I am getting my head beat up in the Banking Committee because of my more conservative stance.

Mr. HALES. Mr. Chairman.

Mr. ROTH. Mr. Hales.

Mr. HALES. The three examples that Mr. Conahan used in fact are rated by the World Bank as low-income countries, not median income countries. And even in countries like India where you have, I believe, a per capita income of about $370 per person, you clearly have a group of folks who tremendously need development assistance.

Mr. ROTH. Does this bank employee with this house here need assistance?

Mr. HALES. Well, that is a nice picture of a nice house. You and I would probably like to live in that house. But I am not sure, Mr. Chairman, where that picture came from. So I cannot comment.

Mr. CONAHAN. Mr. Chairman——

Mr. ROTH. Wait a minute. Mr. Conahan, tell me about that.

Mr. CONAHAN. That picture was taken——

Mr. ROTH. So when I get my head beat in later on today when I go to banking, I want to take this with me, so I have some ammunition to shoot at them.

Mr. CONAHAN. The support behind our statements concerning that house is as solid as you can get. We took those pictures of that house. That house is owned by an employee of the bank that is administering the Housing Investment Guaranty Program in that country. And the person is not lower than median income.

But what I would also like to say is that——

Mr. ROTH. Well, the question I have, if I can just interject quickly—Is he working for the bank?

Mr. CONAHAN. That is administering.

Mr. ROTH. That is a conflict of interest, is it not?

Mr. CONAHAN. I do not make that point at all, sir.

Mr. ROTH. All right.

Mr. CONAHAN. But the point that I would like to make, and again I do not want this to be contentious either, is I do not characterize India or any of these other countries as middle income or otherwise. But I did say that they are less risky than some of these other countries, and the methodology takes that into account. I think that is important.

Mr. ROTH. I want to give Mr. Hales a chance to answer the question. You make the argument that only one country has permanently defaulted, and that you expect the government to pay back eventually.

How long do you plan to wait? You have rescheduled some of these loans ten times. How many times do you have to reschedule them until you say, "hey, I think that we have got a problem here"?

Mr. HALES. I think again that we have to make a distinction between pre and post-credit reform. For the pre-credit reform area, we are in a situation where rescheduling of debt is beyond the control of the U.S. Government. And we do all work for the same government. We can all share concerns about that degree of rescheduling. No action that we can take now about terminating this program is going to change that liability.

The macroeconomic forces which cause rescheduling of debt are of very different kinds of factors than those which we are looking at when we are trying to promote integrated sustainable development.

We are not in the business of building housing units. We are in the business of trying to create a sector that lets folks do that for themselves. We think that we have been successful at that. But it is not a scientific endeavor. It is an art form. And sometimes what we do works, and sometimes what we do does not work. And we try to learn from that and make the program better, Mr. Chairman.

If loans continue to be rescheduled, and we are still getting return for the American taxpayer of $7 in development investment, or $5 under the worst assumption, of development investment for $1 dollar, that is a far better cost, real cost, but a far better cost for a development program than 100 percent of that cost being paid by the American taxpayer, if we went out through a grant approach to try to provide those same services.

The challenges that we have to meet in the urban environment, the meeting of human needs in the urban environment, are not going to go away whether or not we have a credit program. We do want to use it responsibly. We do want to use it appropriately. Its use has been narrowed by the Credit Reform Act. There is no question of that. We do think that it is an important tool in that particular place where it can be used effectively.

Mr. ROTH. Why, then, has USAID given out new guaranties to governments that have already caused bad loans?

Mr. HALES. Well, in each of those cases, those were prior existing agreements legally binding that were signed prior to credit reform. And again, there is specific reference in the Credit Reform Act that authorizes the continuation of those legally binding agreements.

Mr. ROTH. So it took the Credit Reform Act to make those changes?

Mr. HALES. I think that the Credit Reform Act was an essential step in the right direction. And from time to time, Mr. Chairman, the point has been made that USAID has exceeded the limit of the program. That, however, is not something that occurred in a nontransparent way. That occurred in a series of appropriations acts, and was recognized in each specific one, as most recently as the 1995 Appropriations Act, where it say without regard to limit.

So this has been a process, as you say, in which we are one government, which we have equal claim to the success, and equal concern I believe about the shortcomings of the program.

Mr. ROTH. Well, I do not know about that, but I know this: we have got to go to our people and make sure that more attention is paid here. There was not enough oversight exercised here, that is for sure. That is what I have been talking about for a number of years.

USAID is authorized to charge fees for these guaranties, but these fees have never come close to covering your claims.

Can you enlighten us on that a little bit?

Mr. HALES. Well, we charge a half a percent per annum on unpaid balance and a 1-percent initial fee on the amount of the loan, which has generated about $142 million over the life of the program. We have written off $39 million in the entire history of this program, all of which were non-sovereign loans. Those are loans which were not loans to governments, but loans to other entities under the program.

So just in that direct comparison in terms of what has been written off and what has been brought in, there is a $103 million surplus in those fees.

Mr. ROTH. Well, I do not know about that. They have been pushing you to increase those fees, and you have never increased the fees.

Can you tell us why?

Mr. HALES. I cannot tell you the entire history of the discussion on increasing the fees, Mr. Chairman. I can say again that we are in the development business, not the banking business. And what we are trying to do is make resources available in a way that they can actually affect sustainable development in countries.

Mr. ROTH. Forgive me, but you are in the banking business. There are American tax dollars all over the world for these programs. You are in the banking business.

Mr. HALES. As you said, Mr. Chairman, I do not want to get into a debate or be contentious about that. And perhaps the phrasing was not felicitous on my part. My point is that our purpose is not to be a bank. I hope that we are fiscally sound in our administration of the program, and in a way that perhaps any banker could be proud of, and that we continue to have acceptable audit reports on the program on an annual basis, independent audit reports that indicate that we are doing that.

I do not mean to minimize that function of the program, but it does have a broader purpose than just lending money. And that purpose is a developmental purpose. And I think that the program will serve the U.S. interest, Mr. Chairman.

Mr. ROTH. I would disagree with that. GAO could not find some of these records.

Where are these records?

Mr. HALES. I do not know the answer to that, Mr. Chairman. Again, as I said, this is a frustrating thing. In fact, it was one of the most prominent concerns when Brian Atwood, Larry Byrne, and others came in and began to revise our financial accounting systems. I think you will find that the system is very different now than it was a year ago, and it will be much more accountable, much more transparent, and much more responsive over the next year. As it should be, Mr. Chairman.

Mr. ROTH. According to GAO, your accounting system has in effect allowed you to issue new guaranties every time you pay out a claim.

Why has this been done?

Mr. HALES. Mr. Chairman, I would want to be careful to give you a good answer on that. But my sense is that the additional room in that is essentially post-credit reform and we have not used that to expand any of the pre-credit reform liability. But let me be absolutely sure.

Mr. CONAHAN. I would have to say that most of that is pre-credit reform.

Mr. HALES. May I give you a good answer, Mr. Chairman. I think that is a very important question. I would not want to rest with the top of my head answer to that particular question. You could ask Don Charney, who is our Chief Financial Officer.

Mr. ROTH. Why do you not submit that to our committee, and we will include it as part of the record.

Mr. HALES. I appreciate that.

[The information referred to appears in the appendix on page 56.]

Mr. ROTH. The answer being, "well, that is pre-this and pre-that." Two years from now or 5 years from now, they will say "that was pre-turn of the century. That was back in the 1990's." That is why I think that we have got to clean up our act now.

It seems to me that USAID has really used this as a grant program, rather than a loan program, That is what I am going to tell Speaker Gingrich and Senator Dole.

How would you respond to that? Would that be unfair?

Mr. HALES. I think it would be, Mr. Chairman.

Mr. ROTH. You tell me why.

Mr. HALES. I will try. I respect your opinion and I know that you have worked with this program much longer, in fact, than I have. But it seems to me that you have to look at this program in terms of its full purpose under legislation: its impact, in an integrated way, on promoting sustainable development and removing the constraints to that development.

And in this instance, what we are looking at is an expenditure that in the worst case scenario still remains $1 out of $5. That does not look like a grant to me. I wish I could get that kind of impact and leverage with the grant operations that we do run. But we cannot, Mr. Chairman, under the best of circumstances, get that kind of leverage.

So I think that there is a distinct difference there. There is a cost to this program. And if you wanted to characterize that particular cost, whatever it may be, 20 cents on the dollar or less, as a grant, I suppose that becomes a semantic game. But that other 80 cents——

Mr. ROTH. A billion dollars is not a semantic game.

Mr. HALES. I would also point out that in those countries where the loans are repaid fully, and we anticipate that will be a majority of countries, that in effect——

Mr. ROTH. What are you doing to get these loans repaid?

Mr. HALES. We continue to work, Mr. Chairman, assiduously to make sure that those countries repay those loans. This is not a responsibility that we take lightly. This is a great concern. If for no other reason than programmatically, the more rapidly they are repaid, the more resources we have to address the problems we are concerned with. Getting rapid return and payment on schedule is very important to us, and we are at 95 percent of appropriate payment on principal, interest, and fees for even the rescheduled loans.

The principal is not being paid that fast, just as you back load your principal when you buy a house and front load your interest.

It is the same situation with these loans. But 95 percent of rescheduled loans are being repaid on schedule this time.

Mr. ROTH. I appreciate what GAO does. It is the investigative arm of Congress, and we are lucky we have GAO, because as you can tell, Congress has gone in 50 thousand different directions, and no one has really been focusing on this. I appreciate the work that GAO has done in this area.

Mr. CONAHAN. Thank you, Mr. Chairman.

I would like to make a comment, if I may, at this point. Because I think that it is important for me to say here that we did in fact differentiate between the pre-credit reform activity and the post-credit reform activity. The bulk of our $600 million number in terms of potential defaults for the future goes to the pre-credit reform activity. We simply accepted the $50 million number that was associated with the post-credit reform activity.

Now it seems to me that then that gets us into the purposes of the program. And if you take a look at the activity post- credit reform, the countries that we are dealing with here are the Czech Republic, Hungary, India, Indonesia, Morocco, South Africa, and Sri Lanka. I think that is a complete list. Which is an altogether different basket of countries from the earlier ones which included a number of countries in Latin America and Africa.

I would expect that the loan loss reserve would be much lower than what we estimated it for the other basket of countries. But then again, these other countries all can get similar financing on the commercial market. And I think that we need to take that into account at this point.

Mr. ROTH. So basically, your recommendation would be that we shut down the program?

Mr. CONAHAN. Well, I think that if these are the kind of countries that we are going to give it to, and they can get similar financing from the private sector, the commercial market, then there is not the kind of need that has existed in the past for this program.

Mr. ROTH. I am sure that Mr. Hales will probably agree with you.

Mr. HALES. May I comment, Mr. Chairman?

Mr. ROTH. Sure.

Mr. HALES. I think that it is true that in some places that we have been successful. In creating markets, where in terms of shelter per se, housing units per se, there is access to private markets. And that is an accomplishment of the program, not a detrimental comment on it.

But about 70 to 80 percent of our investment now does not go to housing units. It goes to the infrastructure necessary to make this other investment possible and to encourage that private sector development.

This program has truly evolved, Mr. Chairman. It should evolve further. And I hope that we can do it in cooperation with you and your committee and with others in Congress who are interested in this.

Again, we do not believe it to be a panacea. We recognize that it needs to be used in a carefully-controlled very responsible way. But when it can be used effectively to achieve development concerns, and we are getting the ability to spend $1 and get $7 in investment credit. Mr. Chairman, that is not a tool that we should put down lightly. I hope we can work together to try to figure out a way to use it and to satisfy your concerns, because I think that they are valid concerns.

Mr. ROTH. Well, we have a $4.7 trillion deficit in this country. We have not even begun to balance our budget yet. Other countries are like people. When I was in business, if people did not have to pay their rent, they would not pay their rent. So you have got to have someone that watches. There is no watch dog here. It is money. When we used to sell real estate, we always tried to sell to some company, because it was not their money. It was always "you guys get a better deal."

And that is the way that it is here. If you reschedule loans ten times, why would they not reschedule the eleventh time? It is very poor business. But I do not hold you responsible. You are just doing your job.

If we in Congress do not have enough respect for the people who send us to Capitol Hill to make the right decisions, I cannot hold you responsible. I hold the Congressmen responsible who, over the years, went along with all of the folderol. "Hey, it is easy to spend the taxpayers' money. Nobody really gives a damn."

And that is what I am going to tell Senator Dole and Speaker Gingrich. We have got to make some changes. We have got to start caring about how we spend this money, and about how we are going to be paid back. Look at this meeting here this morning. Congressmen are not focusing on these things. They are just over there spending more and more money. Nobody gives a damn. But you know something, they are going to give a damn. Because they are going to wake up one morning, and this whole house of cards is going to come down. You cannot continue with $4.7 trillion debts. That is why we have to do something now.

I appreciate, Mr. Hales, that you are a strong advocate for your program.

Mr. Conahan I appreciate, you and your colleagues at GAO. I am sure that it takes a lot of guts to come up here and say, "hey, there are some mistakes here," especially if the Congressmen do not want to hear that there are mistakes. But a blind man can see that this is never going to work out. It would not work out if it were in business, why in the heck would it work out here?

But I appreciate your comments this morning. You are wonderful fellows. If I were in business, I would wish I had you working with me. Thanks a lot.

[Whereupon, at 11:19 a.m., the subcommittee was adjourned.]

APPENDIX

STATEMENT OF CONGRESSMAN SAM GEJDENSON HEARING ON HOUSING GUARANTY PROGRAM

I commend Chairman Roth for calling this hearing and giving the Subcommittee the opportunity to receive testimony from GAO and AID regarding the Housing Guaranty Program.

For several years now, this Subcommittee has had serious concerns about the Housing Guaranty Program. After giving the program repeated opportunities to correct matters, we asked, on a bipartisan basis, for GAO to do a thorough scrub. We appreciate their very fine effort.

HIG is a program that has lost its way. The program has lost a billion dollars and is expected to lose at least 60% more. To compensate for this failure, HIG has changed the profile of the countries in which it operates.

No longer is HIG working in the truly poor nations, which is where Congress intended it to be. HIG is now in the more advanced creditworthy countries such as India, Indonesia and Thailand.

Nor is HIG helping those that Congress intended to receive its help. GAO has found that HIG does not meet the legislative requirement that 90% of loan funds be used for projects suitable to below median income. GAO found that HIG does not insure that projects actually benefit the target population. GAO also found that there is no empirical evidence that policy reforms have had significant impact on private investment in low income housing.

Simply put, there are better ways to spend taxpayer money; especially given the GAO finding that HIG has guaranteed new loans to defaulted borrowers and multiple reschedulers of loans.

As one who supports AID and helping those who are truly in need of our assistance, I believe that HIG is not the way to achieve that noble objective. HIG has let down those of us who do support foreign aid, and more importantly, HIG has let down those who would have benefitted from a more responsible and responsive program.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on International Economic Policy and Trade
Committee on International Relations
House of Representatives

For Release on Delivery
Expected at 10:00 a m. EST
Wednesday
June 28, 1995

FOREIGN HOUSING GUARANTY PROGRAM

Goals Are Not Achieved and Financial Condition Is Poor

Statement of Frank C. Conahan, Senior Defense and International Affairs Adviser to the Comptroller General

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our recent report on the U.S. Agency for International Development's (USAID) Housing Guaranty Program, entitled Foreign Housing Guaranty Program: Financial Condition is Poor and Goals Are Not Achieved.[1] A fundamental long-term goal of this program is to increase shelter for low-income families in developing countries by stimulating local institutions to provide the necessary investment capital and other resources. The Foreign Assistance Act and subsequent amendments have authorized the use of different strategies and tools to achieve this goal. Since 1961, USAID has guarantied over $2.7 billion in loans in 44 countries under this program for home construction, mortgages, home improvements, urban infrastructure, and other shelter-related projects.

We examined this program at the request of members of this subcommittee, who had long-standing concerns about the program's evolution, financial condition, and impact in the developing world. We performed our work at USAID headquarters and in seven countries in South America, Asia, North Africa, and Eastern Europe. Our fieldwork included visits to project sites and discussions with local government and private financial institution officials. We also conducted a thorough review of the program's audited financial statements and

[1]GAO/NSIAD-95-108, dated June 2, 1995.

related records.

SUMMARY

Our work has led us to conclude that the Congress should consider terminating this program.

Over the past 34 years, the Housing Guaranty Program has evolved from financing homes constructed by U.S. firms in Latin America to financing an assortment of shelter-related activities in many parts of the world. Increasingly, assistance has gone to advanced and creditworthy developing countries--countries that have ready access to international financing.

The program has not had the intended impact of stimulating local private sector investment in low-income shelter. Instead, in the countries we visited, the program has basically provided supplementary funds for host government low-income housing and related infrastructure financing. Further, USAID does not always know whether the program is benefiting the poor target population. We found numerous instances in our fieldwork in which this program was benefiting higher-income families.

Many borrowers have defaulted on loan payments, forcing USAID, as guarantor, to make these payments for them. The fees that USAID charges borrowers do not generate enough income to cover these costs. As a result, the total cost to the U.S. government for this program due to loan defaults is likely to be about $1 billion in constant 1995 dollars. This does not include several hundred million dollars in technical assistance that USAID has provided borrowers to help implement the projects that are financed.

PROGRAM EVOLUTION

The program has evolved in three respects: its approach, the type of projects funded, and its geographical scope. While these changes appear reasonable, we believe the change in the profile of borrowers raises questions about the need for this program.

The program's approach has evolved from conducting demonstration projects using U.S. firms to involving and supporting local institutions. More recently, the emphasis has shifted toward policy reform as an explicit recognition of the limited impact of demonstration projects alone in countries whose policies discourage efficient development of shelter for the poor. This shift and the provision of technical assistance to help program borrowers use their loan funds effectively were reasonable management decisions.

Beginning in the 1970s, the program shifted from financing U.S.-style housing projects to financing more basic, minimum standard housing. More recently, the scope of projects financed has expanded from housing to urban services, such as sewers and water treatment plants, electricity, and roads, to support housing construction and upgrading. This change was consistent with the program's intent to make housing more affordable to the poor.

However, USAID has increasingly provided assistance in more advanced and creditworthy developing countries. Given the risk of loan defaults and U.S. budgetary constraints, this choice of borrowers may seem to be more appropriate; however, these borrowers may have less need for this type of assistance than other countries. We recognize that some of the loan guaranties under this program were approved for foreign policy considerations. However, a key factor in the overall shift in borrowers is the implementation of the Federal Credit Reform Act of 1990. This act requires appropriated funds to be set aside to cover probable loan defaults. As a result of this requirement, USAID has scaled back its loan guaranties in countries that are higher-risk and lower-income, which require larger reserves for probable defaults. Recent programs have focused on countries that currently have ready access to comparable loans from other international lenders. These countries include USAID graduating countries, such as Tunisia and Thailand, and more creditworthy countries, such as India and Indonesia.

IMPACT ON LOW-INCOME SHELTER INVESTMENT

After 34 years of existence, there is still little evidence of progress toward the Housing Guaranty Program's fundamental, long-term objectives. As I pointed out earlier, the program is intended to finance demonstration projects that would stimulate local private sector investment in low-cost shelter projects. While the program has included the local private sector in the delivery of housing and infrastructure financed by the developing country governments, USAID documents and our fieldwork showed that the program has not convinced local private investors to risk their own capital in similar projects. Instead, in the countries we visited, the formal low-income shelter markets are still heavily dependent on government-furnished subsidies and financing.

For example, in Tunisia, long-term financing for low-income housing is generated through a payroll tax instead of from private sources. A USAID-sponsored study indicated that rates of return on mortgages are too low for private financial institutions to offer their own capital. In Ecuador, private bankers we visited told us that they could not afford to offer low-income mortgages without subsidies from the government. In India, also, private lenders rely on government financing at subsidized rates to make home loans available to low-income customers. A USAID consultant in India concluded that instead of leading to increased low-income shelter investment, the USAID program in that country had simply created another conduit for distributing government resources. In Indonesia, USAID consultants reported little progress in replacing government financing of infrastructure projects with private financing.

The Foreign Assistance Act requires that at least 90 percent of the guaranties issued under the program be used to finance shelter suitable for families with incomes below the country's median income. However, our review showed that USAID does not always ensure that the projects it finances are benefiting the program's poor target population. In the countries we visited for this review, we found instances where housing financed by the program was not or appeared not to be benefitting low-income families. For example, our review of the program in India revealed that a participating bank was lending program funds to its own upper-income employees for home improvements. In Indonesia, the program financed infrastructure projects we visited in higher-income neighborhoods.

In several cases, USAID documents confirmed our observations that a significant portion of beneficiaries probably had above-median incomes. For example, according to a USAID consultant study, about 36 percent of Housing Guaranty Program funds in India were benefitting upper-income families. A similar study in Tunisia showed that 17 percent of a sampling of eligible beneficiaries had above-median incomes. In other countries we visited, USAID consultants noted the potential for this problem but did not attempt to document its extent. For example, a consultant study in Indonesia reported "conflicting speculation" about whether infrastructure projects were benefitting the poor. In Ecuador, representatives of a nonprofit agency working with USAID on one major housing project reported to us and to a USAID consultant that many beneficiaries appeared to be upper-income families.

Additionally, it is important to point out that USAID has not designed its performance indicators to measure the program's progress in stimulating private investment and providing shelter to the target population. Instead, USAID measures a variety of large-scale shelter sector changes that cannot be directly attributed to the program, such as infrastructure expenditures per capita and house price-to-income ratios.

FINANCIAL CONDITION

The U.S. government's total net cost for the existing portfolio of loans is likely to be about $1 billion. This is because many borrowers have defaulted on loan payments and we project they will default in the future. USAID, as guarantor, must make the payments for them. The fees USAID charges have not generated enough revenues to cover the costs USAID incurs when borrowers default .

Since 1970, the program has required $417 million (in 1995 dollars) in appropriations and $125 million in loans from the U.S. Treasury to cover loan defaults. We estimate that the cost to the U.S. government of future loan defaults from the existing portfolio of loans is likely to be an additional $600 million. Since fiscal year 1992, the Credit Reform Act has required USAID to set aside a reserve fund with appropriations to cover the estimated future cost of defaults on its newly guarantied loans. However, because this was only a recent requirement, USAID has only enough reserves ($50 million) to cover defaults on loans authorized after fiscal year 1992.

The potential cost to the U.S. government could be reduced by deauthorizing, where feasible, the nearly $193 million in guaranties that were issued before 1992 on loans that have not yet been disbursed.

USAID Housing Guaranty Program officials disagree with our $1 billion cost projection, because they feel they will eventually recover nearly all default costs from the defaulted borrowers. However, the results of USAID's efforts to date are not encouraging. USAID has recovered only about 5 percent of the debt it has assumed under the program, and the outstanding balance of uncollected debt owed to USAID grows each year. Based on our estimates of probable default, we project that USAID will ultimately recover only about $200 million of the $542 million the program has cost so far. Many defaulted borrowers have avoided repayment by repeatedly rescheduling the debt--one country has rescheduled its debt to USAID 10 times. Nonetheless, in several cases, USAID continued to guaranty new loans for countries that were in arrears and repeatedly rescheduled their debts--increasing the U.S. government's exposure.

It is important to note that while our projection of future default costs is about $600 million, USAID's own auditors estimate these costs at over $700 million in their fiscal year 1993 audited financial statements, which were the most recent available at the time of our review. Our projection reflects more current country risk data than USAID's and is derived from the secondary market's expectations of default.

It should be pointed out that in addition to the costs already discussed, USAID has provided several hundred million dollars in technical assistance to program participants; $471 million is programmed for ongoing projects alone. These costs are not reflected in the program's budget or financial statements and is not considered by USAID to be a cost of the program.

One other issue needs to be mentioned with regard to the financial condition of the program--the $2.6 billion ceiling in the Foreign Assistance Act on outstanding loan guaranties issued prior to 1992. This ceiling has not been effective at limiting the government's financial exposure from this program. Every time some amount of loan principal was paid off, USAID was allowed, under the legislated ceiling, to issue a new guaranty for a corresponding amount. However, as we have pointed out in our report, in many cases USAID itself made principal payments on behalf of defaulted borrowers. Thus, USAID was able to issue new guaranties even when the borrower itself did not repay the principal that was due. If USAID had been required to include overdue amounts owed by borrowers under the legislated ceiling, it would have issued $200 million less in loan guaranties. This would have reduced USAID's probable default costs by an estimated $50 million.

As you know, our recent report suggested that the Congress consider terminating the Housing Guaranty Program because

-- the program is increasingly benefiting more creditworthy and advanced developing countries that have access to comparable loans from other international lenders;

-- the program has not stimulated local private sector investment in low-income shelter as intended; and

-- the program annually costs the U.S. government millions of dollars more than anticipated.

MATTERS FOR CONGRESSIONAL CONSIDERATION

You and the Members of the House of Representatives have already initiated action to terminate this program when you passed H.R. 1561. Section 3251 of that bill repeals housing guaranty authority and denies aid to any country that is in arrears on a loan guarantied under this program.

In the event the program is not terminated, we believe that the Congress should consider requiring USAID to develop a comprehensive plan for reforming the program to achieve its legislated goals and reduce its cost to the U.S. government. Our report also contains several recommendations to USAID to improve the management of the program.

This concludes our statement, Mr. Chairman. I would be glad to take your questions now.

(711144)

Testimony of David Hales
Director of the Center for the Environment
U.S. Agency for International Development
Before the House International Relations Committee
Subcommittee on International Economic Policy and Trade

June 28, 1995
Washington, D.C.

Mr. Chairman:

Thank you for the opportunity to appear before the Committee. I welcome the chance to set the record straight on the U.S. Agency for International Development's (USAID's) Housing Guaranty programs.

Over the past 30 years, the Housing Guaranty program has proved to be a vital tool for promoting key U.S. foreign policy interests, providing economic opportunity for American firms, encouraging substantive policy reform by developing country governments, and most importantly, helping millions in the developing world acquire the most basic needs in shelter, sanitation and clean water.

The Housing Guaranty program has provided the U.S. Government with a seasoned and experienced rapid response capability during crucial foreign policy junctures in Eastern Europe, South Africa, Israel, Chile, Zimbabwe, Portugal and the Philippines. Not only does the Housing Guaranty program clearly advance a number of U.S. national interests, it is a financially sound program that provides an efficient, relatively low-risk way to use scarce foreign assistance dollars to encourage needed policy and operation reform in developing countries.

In this era of reduced budgets, this is a good way to get a big bang for our limited buck. Consider:

- Each dollar of budget authority for this low-risk credit program leverages about seven dollars of development assistance from other sources.

- This reserve is funded at about 15 cents for each dollar guaranteed -- even though over the history of the program the U.S. government has written off as unrecoverable only one and 1/2 cents on each dollar loaned. ($39.3 million out of $2.8 billion in loans.)

- The portfolio has experienced no defaults or write-offs since Credit Reform was implemented in 1992 as a result of the Federal Credit Reform Act of 1990.

- No country has ever permanently defaulted on their loans under the Housing Guaranty program.

- USAID has collected 95.6 percent of principal, interest and fees due from rescheduled borrowers over recent years.

- Using $400 million worth of appropriations, this program has created $2.8 billion worth of loans.

The Housing Guaranty program remains the primary tool the United States has for addressing urban development needs worldwide. Under this program, the U.S. private sector provides long-term financing for low-income shelter and basic infrastructure projects that improve access to clean water, sewage and other basic services that directly benefit low income families. The U.S. government guarantees loan repayment through the program. Housing Guaranty programs have accomplished significant, sustainable policy reforms which have increased the access of poor families to shelter and basic urban environmental services. Guaranty programs are now active in some 20 countries, including South Africa, India, Indonesia, Morocco and Poland.

A key feature of the Housing Guaranty programs is working with developing country governments on policy reform needed to deal with rapid urbanization. Without policy change, often accompanied by relevant training, urban improvements will not prove sustainable.

USAID housing guarantees have helped hundreds of thousands of poor families. Even within the relatively better credit risk countries we assist -- some of which are on the way to becoming USAID "graduates" -- large groups of people often live in squatter settlements and other lower-income urban areas. Those individuals most in need of basic urban infrastructure to protect their health and well-being are usually extremely difficult to reach -- in both developed and developing countries alike. Our loans have had a direct and measurable impact on such families, including the "poorest of the poor."

Furthering U.S. diplomatic efforts, strengthening America's economy, helping the poorest of the poor and building the foundations of good and democratic governance -- these have been the basic tenets of the Housing Guaranty program. In light of these many achievements, we can not help but be deeply disturbed by the recent report by the Government Accounting Office on the Housing Guaranty program.

As we have expressed in writing, USAID strongly disagrees with the GAO report's findings. We have provided every evidence that the Housing Guaranty program is a cost-effective method for pursuing development assistance and that the program has achieved the goals established by the Congress.

We have a number of fundamental disagreements with the GAO report's findings. The most serious allegation is that the program is in serious financial trouble. This is simply not the case. The GAO makes the rather incredible assumption that of the 17 countries who have rescheduled loans, a significant number will default on their loans with zero repayment. Yet, since 1964, not one nation has permanently defaulted on their loan guaranty through this program. Peru, for a brief period, attempted to take a path of total default, but found it so onerous to their national interest they reentered payment. The GAO's economic forecast assumes a worldwide credit crisis of unrealistic proportions.

The ramifications of significant numbers of nations defaulting on their financial commitments would have major implications far beyond the Housing Guaranty program. Such a profound occurrence would shake the very foundations of the international financial community. Yet, the GAO has provided precious little substance to back these very serious claims of a possible global financial crisis.

In keeping with the Credit Reform Act, the current Housing Guaranty program receives annual appropriations projected by the Inter-Agency Country Credit Risk Assessment System to be sufficient to cover future costs. The Housing Guaranty program makes up only about two percent of the total portfolio managed by the Inter-Agency Country Credit Risk Assessment System. This interagency team clearly does not share the pessimistic view of the Housing Guaranty program's financial liability to the American taxpayer. USAID estimates of financial liability are calculated by exactly the same method used by other executive branch agencies. The GAO assumes that even after substantial program improvement through the Credit Reform Act, default rates will be far higher than they have been at any time in the program's history, and that liability projections of the interagency team are miscalculated by tens of billions of dollars.

The financial assumptions made by the GAO are clearly not shared by the Office of Management of the Budget or USAID. GAO has also failed to show that the Congressional Budget Office agrees with the basic precepts of their presumptions. Nor is there any reason to believe these utterly gloomy assessments are shared by the financial community at large. I would be happy to forward further technical documentation as to why the GAO's approach is fundamentally flawed.

It should be stressed that the post-Credit Reform Housing Guaranty program has sustained no write-offs or investors' claim. In addition, the post-Credit Reform program has a fully funded reserve to cover the estimated risk of all future claims. This reserve is funded at about 15 cents for each dollar guaranteed -- even though over the history of the program the U.S. government has written off as unrecoverable only one and 1/2 cents on each dollar loaned. We believe this is fiscally conservative, and past experience supports that assumption.

Through the Credit Reform Act of 1990, Congress substantially improved many of the financial shortcoming of U.S. government credit programs. The Housing Guaranty program now loans to nations that are more credit-worthy than ever before, while preserving its character as a tool to assist low-income countries. The Credit Reform Act, as I have mentioned, also put in place a mechanism to ensure a fully funded reserve for any potential financial liabilities. In short, the Housing Guaranty program has been financially sound, and today it is more so than ever.

It is telling that the GAO makes little or no reference to the Credit Reform Act in their findings. The post-Credit Reform Housing Guara..ty program is financially sound -- a fact that GAO representatives acknowledged in an April 27th meeting with USAID official and Congressional staff aides. A conclusion of this relevance should certainly have been included in the report. We submit that the GAO report focusses unduly on the past. Credit reform was welcome and overdue, and the GAO is remiss not to take its impact into account.

The pre-Credit Reform program has written off $39.3 million -- about one and one-half cents per dollar guarantied. Over the past 30 years, USAID has paid $408.9 million in claims to investors on pre-credit reform guarantees -- about 15 cents for each dollar guarantied. Of that figure, a significant portion is likely to be recovered. The GAO acts as if rescheduling a loan repayment means that we will not see any payment at all. In fact, the opposite is true. Over recent years, our repayment rate on rescheduled loans is running around 96 percent.

The report indicates that the program has shifted toward participation by more advanced developing countries and that USAID does not ensure that the program targets the below-median income populations. It is true, as part of the Credit Reform Act, that we target more credit-worthy nations. But this fact means neither that these nations cannot be low income, that those nations do not have significant poor populations or that these nations have access to loans required to undertake water, sewage and sanitation projects. Although USAID has sought to minimize risk by operating the program in creditworthy countries, the program is meeting the Congressional intent and has benefitted millions of low income people -- as the examples in this testimony attest. The Housing Guaranty program is an effective tool to help move nations to the point where they are ready to graduate from the need for U.S. assistance.

The Report says that our program has shifted toward more advanced countries. Excluding Congressionally mandated countries such as South Africa and Israel, our loan guaranties to low-income countries since 1990 have increased by 40 percent, while those to lower-middle income countries have declined by 45 percent. Where the program does operate in more creditworthy, but not necessarily richer countries, the use of Housing Guaranties affords the U.S. a way to provide cost-effective assistance (at less risk to U.S. taxpayers) as a transition to these countries becoming USAID "graduates."

The Housing Guaranty Program has indeed changed significantly over the years. It continues to extend guaranties to U.S. private investors who make loans to public and private institutions in developing and newly independent countries. But it also reflects the facts of economic life in developing countries and responds to specific Congressional mandates for change since the beginning of the program -- including the need to serve the poor majority. Here are some examples of the way this program has changed to deal with today's reality.

We were directed ten years ago to expand the program's scope to include "essential urban development services." So now we advise developing country governments to stop building houses themselves, to instead facilitate private sector financing and building of low-cost shelter, and use their limited public construction budgets to make available to low-income families the most basic urban environmental services, like clean water, sewer, solid waste removal, roadways, and slum upgrading. Over seventy percent of our guarantees are currently used to finance such basic urban infrastructure. Improvements in water and sanitation have led to dramatic reductions in child morbidity.

Here's another change in the program. The lowest-income groups in developing countries are still too poor to become near-term entrants in their countries' formal credit markets -- a long-range goal of the guaranty program. Most recent Housing Guaranty activity has focused, instead, on the housing-related and infrastructure activities also called for in the Foreign Assistance Act. Thus we have tried, with a fair degree of success in our view, to gear our programs to both the long-term goals expressed in the Foreign Assistance Act and the specific kinds of Housing Guaranty activities which that Act's most recent updating of our mandate explicitly directs us to emphasize.

The GAO report makes a number of recommendations, some of which are as reckless as the methodology used in preparing the report. As for deauthorization or rescission of undisbursed loan guaranties, I think such unilateral revocation of U.S. commitments would be a very unwise and disturbing signal for foreign governments and the American financial community. Deauthorization of undisbursed loan guaranties would result in canceling $215 million of legally binding agreements.

Further, abruptly ending these programs would bring strategically important programs in South Africa and Eastern Europe to a grinding halt. Ending Housing Guaranty programs would also significantly diminish USAID's ability to improve the health of hundreds of thousands of low-income women and children who would benefit from potable water and the disposal of wastewater from their communities.

There is much that the GAO has failed to consider. The Housing Guaranty program helps foster privatization and the growth of free markets by successfully utilizing American models of financing urban infrastructure and encouraging developing nations to limit or end state-control of housing. This program has helped strengthen local governments, local private sectors, and community groups -- serving not only a means to achieve economic development, but also as a vehicle for strengthening the foundation of the democratic process.

The Housing Guaranty program offers major benefits for American business and trade. In Indonesia, India, and Thailand, USAID has worked to identify commercial opportunities in urban environmental infrastructure projects for U.S. environmental technology firms. USAID has worked with national and municipal governments to identify projects in the pipeline which will be bid on by U.S. firms or international consortia with U.S. participation. After only 15 months, the Housing Guaranty Loan program has identified more than $590 million in potential contracts for environmental technology, goods, and services suitable for U.S. firms. To date, the project in Indonesia has resulted in $5.7 million in such contracts being awarded to U.S. companies. Another $22 million in contract awards are expected later in 1995.

The Housing Guaranty program is built around the expertise of U.S. organizations. We are proud to work with organizations such as the United States International City Managers Association, the National Associations of Realtors and Home Builders, Fannie Mae, and others to help local governments devise needed policy reform and strengthen key institutions. For instance, recent "twinning" projects -- whereby U.S. cities are paired with cities in developing countries -- have resulted in municipal officials from Louisville, Kentucky, Raleigh, North Carolina, and Seattle, Washington visiting counterparts in Nakorn Sawan, Thailand, Tetouan, Morocco, and Surabaya, Indonesia respectively, to discuss the wide range of U.S. technology available for use in the areas of water and wastewater treatment. These programs are generating economic ties that will serve this country for years to come.

The GAO report simply ignores the many successful Housing Guaranty programs. In Chile, Housing Guaranty programs have produced over 4,400 homes for low-income families. $10 million in Housing Guaranty funds has produced over $45 million worth of low-income housing through private sector housing cooperatives. The Morocco Urban Environmental program has brought potable water to 90,000 people for the first time.

In many instances, Housing Guaranty programs have worked because they have encouraged governments to abandon inefficient state-dominated models of management. Through policy reforms, this has allowed developing nations to both invigorate the private sector, and to more effectively address the needs of the poor. For example, Morocco's Housing Ministry, at our suggestion, divested itself of direct responsibility for housing lot development and created an independent agency less tied to government bureaucratic rules. Today, this innovative agency is able to borrow most of its funds short-term from Moroccan banks, and sells land it has developed for housing to private builders. The Housing Guaranty program was key in helping this agency get on its feet.

With USAID advice through the Housing Guaranty program, Hungary's Government took major steps toward a more rational market-based system of housing finance. Interest rates on new housing loans were allowed to move to market levels. Loan subsidies declined from 8 percent of total government expenditures in 1992, to an estimated 5 percent in 1994. Private individuals are now free to hold real estate for investment; they have been empowered to evict tenants for nonpayment, and can terminate leases for non-performance.

In Zimbabwe, an American-owned firm and an indigenously-owned, private sector housing finance institution have embarked upon an innovative funding and construction scheme -- which employs a cost-saving American steel frame-building technique. This innovation permits the construction of over 4,000 low-cost housing units to be built in 15 working days, as compared to an average of 40-60 working days for houses built using locai techniques. The U.S. firm has introduced the American concept of sub-contracting out most of the construction work as a means to cut costs and save time. The U.S. firm provided training to its sub-contractors, the majority of whom are small black firms as part of the Housing Guaranty program which has transformed Zimbabwe's shelter sector.

The United States has become a leader in influencing policy formulation related to fundamental shelter and urban environmental concerns. Policy reform, training, and access to a strong pool of private sector U.S. urban expertise give the United States a unique advantage in the field. U.S. support of these programs through the Housing Guaranty program is also paying important benefits for helping cement the foundations of democracy in a number of nations.

USAID Housing Guarantees in Indonesia are tied to that country's efforts to enhance local government's ability to finance urban infrastructure and services. By the end of last year, significant increases were registered in local government discretionary funding; the percentage of the urban population covered by locally generated investment plans; local investment in urban infrastructure services; local utility revenues; private sector participation in urban service provision; loan disbursements to local governments; and the number of well-trained, central government staff reassigned to work at regional levels. By advising on a framework to guide and monitor decentralization, our regional office in Jakarta helped set in motion a process that has taken on a life of its own. Central government officials increasingly have taken the lead in proposing more local government authority over financial resources, and in improving local capabilities, accountability, and interest in finding new ways to engage citizen and nongovernmental participation in local planning and resource mobilization. Technical assistance, without the benefit of capital assistance through the housing Guaranty program, would not have achieved these results.

I must reiterate, the Housing Guaranty program is a valuable asset to the United States and to the poorest of the poor. If we abandon this program, we would be doing so on the basis of an isolated and badly flawed analysis. The cost to the United States and to the developing world of abandoning our commitments would be high indeed.

Thank you.

Response to the Hearing by the
House International Relations Committee
Subcommittee on International Economic Policy and Trade
June 28, 1995
Washington, D.C.

Seven organizations representing U.S. housing interests in the United States and overseas, attended the Committee's hearing on USAID's Housing Guaranty Loan Program (HG). The purpose of the hearing was to air the findings of the GAO's audit report on the HG Program. The hearing also provided an opportunity for USAID's Center for the Environment, the organization administering the HG Program, to present testimony in response to the audit report.

The purpose of this document is to address some perceptions of the HG Program that may have been caused by the hearing and the GAO audit report.

In general, it appeared that the hearing did not give sufficient weight to the testimony and facts presented in the Housing Guaranty Program's defense.

o A photo prop used in the hearing created an improper and untrue perception of the housing that is financed by the HG Program. It was inferred that the HG Program is financing housing for upper income groups (not its Congressional mandate), and that USAID controls are inadequate to prevent abuses in its administration of the program.

o The photo perception created was far from accurate. It illustrates an expensive villa financed by a loan to an employee of a lending institution administering funds made available through an HG Program. The house shown in the illustration was indeed financed by the lending institution. However, the house in question was <u>not</u> financed with HG funds. We have attached a copy of our research in this regard along with photos of housing which <u>is</u> typical of that financed under the HG program.

With respect to the GAO's testimony and report, we would argue that its approach and methodology unfavorably distorted the true performance of the HG Program:

o If the GAO's key concern is HG Program risk, it has not made a convincing case: more analysis would have been required for pre- and post- credit reform. It should have examined the effect of all historical defaults and payment delays on each loan and differentiated between rescheduling caused by the macro-economic environment and that caused by the HG borrowing entity.

o The GAO ignores the substantive steps which have been taken to reduce risk after credit reform. Fundamentally, all entities offering credit with U.S. government guaranties now operate under the same rules. This includes the Departments of Defense and Agriculture, the EX-IM Bank, OPIC and the USAID HG Program. Risks which govern U.S. guarantied lending in all foreign countries is determined by a rating system (ICRAS) administered by an inter-governmental agency which includes the OMB and Department of the Treasury. Each agency, such as USAID, then budgets for and sets aside a reserve or subsidy to cover the risk. Furthermore, all programs are subject to an independent outside annual audit. Price Waterhouse has audited the HG Program on behalf of USAID's Inspector General. These audits suggest that the program is financially sound. The GAO, itself, confirmed the program was now financially sound in a March 1995 meeting with staff from the House International Relations Committee.

o To determine contingent liability for the HG Program, the GAO presents all loans (and write-offs) in 1995 dollars even though this does not represent true liability. There have been $2.8 billion in loans to date during the 30-year history of the HG Program. The value of these loans will not increase or decline. Yet, the GAO inflates the value of the loans to $4.8 billion (in 1995 dollars), then assumes that a risk reserve of 19 cents on every dollar of the inflated loans values is the U.S. Government's contingent liability: nearly $1 billion. Even if 19 cents on the dollar is needed for a reserve fund, the contingent liability could not exceed $532 million based on the true value of these loans. USAID argues that $400 million is a more likely, but very conservative, estimate of contingent liability.

Elimination of the HG Program will not resolve the potential contingent liability issue. The issue which GAO should have addressed is whether the potential costs of the HG Program, under credit reform, adversely outweigh the benefits of a leveraged credit program. This analysis was not conducted.

o The GAO report and the hearing made repeated references to the fact that many HG loans have had to be rescheduled. What was not made clear is that rescheduling was the outcome of Paris Club macro-economic discussions between the debtor country, multi-lateral financing institutions, and bi-lateral creditors. Rescheduling of all country debt was made including HG loans. Rescheduling has never been the result of the borrower's performance in servicing the HG debt, but that of the country as a whole.

Furthermore, rescheduling of loan principal does not suggest that the debts will not be paid. One could argue that the total interest received by the lender will exceed that originally anticipated.

o A perception has been generated that numerous borrowers have defaulted on HG loans. On the contrary, in the 30-year history of the HG Program there has been a single defaulting borrower: Iran. Peru nearly chose to default but wisely did not. The circumstances leading to the exceptional default by Iran are surely understood.

o The GAO Audit report did not differentiate between HG Program performance in pre- and post- credit reform. In fact, the GAO report makes little or no reference to credit reform. The Credit Reform Act of 1990 was a laudatory initiative to reduce U.S. government risk in the provision of U.S. loan guaranties. These reforms resulted in a risk reserve to cover the potential cost of future claims: on average 15 cents for each dollar guaranteed. USAID has implemented these recommendations and credit risk assessments were made more stringent. Since these reforms were introduced no HG debt has been written off, no defaults on loans have occurred, and all independent audits have been positive.

o USAID pointed out in its testimony that only $39.3 million out of $2.8 billion in loans has been written off in the program's 30 year history, while $400 million has been paid to investors because of late payments. USAID expects to be repaid this amount by the borrowers as it has been in the past. Thus, the current risk reserve should be sufficient to cover the risk based on the program's history. Secondly, during the 30-year history of the HG Program, USAID has collected $142 million on the loans as administrative fees to cover the costs of managing the program. This is one of the few U.S. programs to be administratively self-sufficient.

o The GAO report assumes that all 17 countries which have rescheduled loans will default on all claims. This ignores the HG's Program's record. As USAID has pointed out, only one nation has permanently defaulted on its HG loan obligations during its 30-year history.

o The GAO report, and the photo discussed above, suggest that the HG Program does not ensure that it targets below-median income households, and that it has shifted participation towards more advanced developing countries. Although the program seeks to minimize U.S. government risk by operating in more credit-worthy countries, the program has benefited millions of low-income people, many of whom now live in upgraded low-income communities. Rates of growth of these communities far exceeds those of middle- and upper-income groups even in advanced developing countries.

o The GAO report recommends deauthorization or recision of undisbursed loan guaranties. This would result in the cancellation of $215 million in legally binding agreements between the United States and sovereign governments. This action would irreparably undermine our national credibility, our foreign policy, and existing and future economic linkages to these countries.

The GAO report ignores the many successful programs fostered by the HG Program. The program provides a vehicle for:

o U.S. investors to enter foreign capital markets.

o U.S. business to enter new markets in housing and environmental services.

o U.S. trade associations to foster linkages with their foreign counterparts.

- U.S. government to leverage scarce public funds at a ratio of more than six-to-one to finance improved housing and environmental services for millions of low income households.

- U.S. government to shore up foreign policy initiatives in the Near East, South Africa, Eastern Europe, and other places of strategic interest.

- USAID to support policy reforms which move away from public sector housing and infrastructure provision towards private sector-led, market-driven models based upon the U.S. experience.

In short, we concur with USAID's position that the Housing Guaranty Program is a valuable asset to the United States and to the developing countries. Rather than engineering its demise, the U.S. Congress should be supporting it as a model for re-engineering foreign assistance.

Attachment A

A Response to the GAO's Photo of HG Financed Housing

Housing Guaranty Loan Program, India

During the GAO Hearing on the Housing Guaranty Program, a photo was shown of a house in India, that was alleged by GAO staff to have been financed with housing guaranty funds, with the loan being made to an employee of the lending institution, also implying the possibility of impropriety.

According to Earl Kessler, Regional Housing and Urban Development Office for India, and Charles Billand, then a Mission Housing Advisor responsible for AID's housing programs in India, *the house in question was not financed* by funds guaranteed by the housing guaranty program.

Mr. Billand accompanied the GAO staff on their field visit when the photo was taken. GAO staff had asked Can Fin Homes, Inc., a division of Canera Bank, to show them some homes for which loans were originated under their programs. To qualify for the overall program, a loan had to be 60,000 Rupees or less ($2,000 or less), and the house had to be under 40 square meters in size. For a primary loan to be re-financed under the housing guaranty program, it also had to have been made to a borrower whose income is below the median urban income in India. *Field staff of Can Fin, such as those met by GAO staff, were not in a position to know if loans were refinanced or not refinanced under the Housing Guaranty Program*. Ultimately, of all the loans made by 30 separate financial institutions, only about 30% were refinanced under the housing guaranty program -- and all of these loans met all of the HG program criteria, including the income test.

The HG program, which is administered by the National Housing Bank in India, has been used to create a secondary market facility which functions in much the same manner that Fannie Mae buys mortgages from financial institutions in the U.S. so that those financial institutions will have the liquidity necessary to continue making loans to the same target beneficiaries. As was pointed out by Mr. Hales, the loans which met all of the eligibility criteria for refinancing under the HG program totaled $220 million whereas the HG loan was only $150 million; thus it is clear that the participating financial institutions made loans to target beneficiaries from their own funds.

Mr. Billand indicated to the GAO staff that the house they photographed was not typical of the program and offered to show them other houses that were more likely to have been refinanced under the program. The GAO staff indicated they knew this house was an anomaly and said they did not need to see other homes. Yet in spite of this information, GAO erroneously presented this photo as evidence that the program is not serving its Congressionally-mandated target group, and inferred impropriety as well.

Enclosed are photos of housing in India which *is* typical of HG financed housing. Also included are photos of HG financed housing in Tunisia, an advanced developing country where the poor have been able to benefit from USAID HG assistance.

ILLUSTRATIVE HOUSING FINANCED BY

THE HG PROGRAM

House in Gujarat, India financed by the Gujarat Rural Housing Finance Corporation, Ltd. A HG borrower.

IChalkaranji: Rural low cost housing financed by HFDC, India

House in La Marsa, Tunisia financed by the Housing Bank on a Land Development Agency site (HG 004 B)

House in Ibn Rachig, Tunisia financed by the Housing Bank on a Land Development Agency site. (HG 004 B)

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COUNTRIES IN WHICH HOUSING GUARANTY LOANS HAVE BEEN RESCHEDULED

Housing Guaranty loans have been rescheduled, under Paris Club arrangement, in 19 countries over the life of the HG program, as indicated below.

Country	Number of Reschedulings	When Rescheduled
Argentina	5	4/86 - 5/93
Bolivia	4	3/87 - 1/92
Chile	2	2/86 - 8/87
Costa Rica	5	5/84 - 11/93
Dominican Rep.	2	3/86 - 10/92
Ecuador	5	3/84 - 7/92
El Salvador	1	11/90
Ethiopia	1	5/93
Guyana	3	9/89 - 5/94
Honduras	2	2/90 - 2/93
Ivory Coast	6	2/85 - 5/92
Jamaica	7	9/85 - 10/93
Jordan	3	10/89-8/94
Kenya	1	7/94
Nicaragua	1	5/92
Panama	2	7/86 - 8/91
Peru	2	8/92 - 8/93
Senegal	10	7/82 - 7/94
Zaire	7	7/80 - 12/89

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NEW GUARANTIES UNDER PRE-CREDIT REFORM AND POST-CREDIT REFORM

All such guaranties were issued in accordance with existing agreements between USAID and the countries and borrowers involved. In this regard, such countries/borrowers met the conditions precedent under these agreements for the issuance of the guaranties. Congressional authority, as written, establishing the legal ceiling for the issuance of guaranties (FAA act of 1961, as amended) allows for replenishment of the ceiling as guarantied loans are repaid, irrespective of whether they are paid directly by the Borrower or by USAID. The older accounting system in use by USAID was not sufficiently transparent for management to monitor closely enough the issuance of new guaranties that in effect replaced those repaid as claims by USAID. With the new accounting system being installed agency-wide at USAID as part of the Agency's reengineering process, management will be in a much better position to monitor this process in a more selective way. We are actively exploring how best to utilize our new accounting system to address the point made by Congressman Roth.

ISBN 0-16-052178-5

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